IN THE

Supreme Court of the United States

OCTOBER TERM, 1944

No. 828

DANIEL O. HASTINGS, as Special Trustee of Standard Gas and Electric Company, Debtor, *Petitioner,*

against

HAYSTONE SECURITIES CORPORATION, a corporation of the State of New York, *Respondent,*

and

H. M. BYLLESBY AND COMPANY; BYLLESBY CORPORATION; WALTER T. ROSEN, HARRY B. LAKE, PAUL MARSHALL ROSENTHAL, HENRY MARCH, JOHN ROSENTHAL and EDWARD E. THALMANN, as Co-Partners doing business under the firm name and style of Ladenburg, Thalmann & Co.; EDWARD E. THALMANN, as surviving executor of the last will and testament of ERNEST THALMANN, deceased; BENJAMIN S. GUINNESS; LOUIS M. LEVINE, ALMA METZ and HENRY L. MOSES, as executors of the last will and testament of Rudolph Metz, deceased; SIDNEY BACHARACH, VIRGINIA M. ROSENTHAL, PAUL M. ROSENTHAL, JOHN ROSENTHAL and FREDERICK M. HEIMERDINGER, as executors of the last will and testament of Moritz Rosenthal, deceased; FIRST SECURITY COMPANY, a corporation of the State of New York; AMEREX HOLDING CORPORATION, a corporation of the State of New York; UNION TRUST COMPANY OF PITTSBURGH, a corporation of the Commonwealth of Pennsylvania; STANDARD POWER AND LIGHT CORPORATION, a corporation of the State of Delaware; ARTHUR C. ALLYN; BERNARD F. BRAHENEY; JOSEPH H. BRIGGS; ORJA G. CORNS; ALBERT S. CUMMINS; HENRY C. CUMMINS; VICTOR EMANUEL; DENNIS T. FLYNN; ROBERT J. GRAF; E. CARLETON GRANBERY; JOHN L. GRAY; ROBERT G. HUNT; HENRY H. JONES; SAMUEL KAHN; WILLIAM C. LANGLEY; CHESTER C. LEVIS; DUNCAN R. LINSLEY; HERBERT LIST; BERNARD W. LYNCH; MATTHEW A. MORRISON; THOMAS A. O'HARA; JAMES F. OWENS; ROBERT F. PACK; WILLIAM G. POHL; JOHN P. PULLIAM; WILLIAM F. RABER; ROYAL E. T. RIGGS; ANDREW W. ROBERTSON; LOUIS H. SEAGRAVE; FREDERICK W. STEHR; T. BERT WILSON; ANNA G. BREWER, as Executrix of the last will and testament of Chauncey M. Brewer, deceased; and MARTIN J. O'BRIEN, as executor of the last will and testament of John J. O'Brien, deceased, *Defendants.*

BRIEF FOR HAYSTONE SECURITIES CORPORATION IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

HORACE G. HITCHCOCK,
Counsel for Respondent.

DWIGHT R. COLLIN,
Of Counsel.

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Opinions Below

The opinion of the Supreme Court, New York County (R. 67) is not reported. The opinion of the Appellate Division of the Supreme Court for the First Department (R. 73) is reported in 265 App. Div. 643 and in 40 N. Y. S. 2d 299. The opinion of the New York Court of Appeals (R. 82) is reported in 293 N. Y. 404.

Jurisdiction

Respondent Haystone Securities Corporation denies that the jurisdiction of this Court can be properly invoked under Section 237(b) of the Judicial Code. No Federal question was presented for decision to the Court of Appeals of the State of New York nor was any right arising under a Federal statute denied to petitioner. Assuming *arguendo*, without conceding, that petitioner succeeded in raising a Federal question, the decision of a Federal question was not necessary to the determination of the case and the case

was properly decided on other grounds without decision of any Federal question.

The questions presented for decision to the Court of Appeals were:

(1) Whether the action was a derivative action on a cause of action belonging to the corporate debtor for a wrong allegedly done to the debtor which passed to petitioner as special trustee,

(2) Whether the action was brought under Section 60 of the General Corporation Law of the State of New York (printed in appendix to Petition);

(3) Whether the action, brought by petitioner as a bankruptcy trustee, with the rights, remedies and powers of a judgment creditor holding execution duly returned unsatisfied, if brought under Section 60 of the General Corporation Law was barred by the State Statute of Limitations (Section 48, New York Civil Practice Act).

The Court of Appeals decided that the action was for a wrong to the debtor, and accrued to the debtor when the wrong occurred; hence, whether or not the action was brought under Section 60, and in whatever capacity the plaintiff sued, it was a derivative action for wrong to the corporate debtor and barred by the State Statute of Limitations.

There was no occasion to decide any question involving interpretation of Section 70e of the Bankruptcy Act. No exception was ever taken to the proposition that a bankruptcy trustee has the rights, remedies and powers set forth therein. The Court of Appeals expressly disclaimed any intention to decide any question as to the power or

capacity of a trustee in bankruptcy to bring this action, stating (R. 86):

> "There would, indeed, be serious doubt whether a trustee in bankruptcy would have capacity to sue upon a cause of action which did not belong to the debtor other than a cause of action to set aside illegal transfers of property and unlawful preferences. (See *In re Jacoby*, 138 F. 2d 42; *Sanford* v. *Boland*, 287 N. Y. 431; *Courtney* v. *Georger*, 228 F. 859, certiorari denied 241 U. S. 660; *Morris* v. *Sampsel*, 224 Wisc. 560; 4 Collier on Bankruptcy [14th ed.], pp. 1182-1183.) We need not attempt to resolve that doubt in this case since we hold that under the law of the State the cause of action here asserted is based upon a wrong to the corporate debtor and accrued when the wrong to the debtor corporation was complete."

The effect of the decision of the Court of Appeals was that, assuming that a trustee in bankruptcy had the rights, remedies and powers of a judgment creditor holding an execution duly returned unsatisfied, as contended by petitioner; and, assuming the suit was brought by such a judgment creditor under the State statute (Section 60, General Corporation Law), as contended by the petitioner; it was nevertheless barred by the State Statute of Limitations.

Questions Presented

Respondent contends that petitioner's statement of questions presented does not find support in the record and does not correctly reflect the basis of decision of the Court of Appeals. It is not accurate to imply, as does the first question propounded by petitioner, that the Court of Appeals decided that an action by a trustee in bankruptcy of the cor-

poration may be declared barred by the Statute of Limitations even though such action would not have been barred if maintained by a judgment creditor. The Court of Appeals held explicitly that the action was equally barred whether maintained by a trustee in bankruptcy or a judgment creditor.

The second question incorrectly implies that it is established that a judgment creditor enjoys a superior position under State law when maintaining an action for wrongs done to a corporation. The decision of the Court of Appeals of the State of New York was directly to the contrary of this proposition. There was no discrimination against petitioner as trustee nor any denial of status as afforded by Section 70e of the Bankruptcy Act. The capacity of a judgment creditor to assert causes of action in the State courts, the nature and scope of the remedies of the judgment creditor, and the limitations upon actions by a judgment creditor all are necessarily questions of State law for final determination by the State court, and cannot be Federal questions.

Statement

Petitioner's "Statement of the Matter Involved" is deemed incomplete for the purposes of respondent's argument.

The nature of the action, as being of a derivative character for wrong allegedly done to the debtor corporation, is manifest from the complaint. It was so construed by both the New York appellate courts. Plaintiff's appointment limited him to the sole function of prosecuting such an action. The United States District Court for the District of Delaware in its order of appointment named petitioner

a "special trustee of and limited to" certain specified claims or causes of action of the debtor Standard Gas and Electric Company described therein "which existed in favor of the debtor prior to September 27, 1935".

Prior to the commencement of this action petitioner had commenced an action against respondent and others upon a complaint nearly identical with the complaint herein in the United States District Court for the District of Delaware. In the prior action he attempted to sustain the jurisdiction of the Delaware Court over respondent on the theory that the action related to "property of the debtor" and was, therefore, within the exclusive jurisdiction of the Bankruptcy Court pursuant to subdivision (a) of Section 77B of the Bankruptcy Act. This contention was rejected by the District Court (30 F. Supp. 21, p. 26). The decision of the District Court was affirmed by the Circuit Court of Appeals for the Third Circuit (119 F. (2d) 658), which held that in Section 77B Congress did not confer jurisdiction over claims by a debtor against third parties and that this was a species of property which might only be realized upon for the benefit of the debtor and its creditors by the successful prosecution of a plenary suit against the third parties involved. Obviously such a plenary suit would be subject to all of its infirmities.

When petitioner commenced this action, defendants successfully moved to dismiss the complaint on the ground that petitioner did not have capacity to sue in the courts of the State of New York. Upon appeal to the Court of Appeals of the State of New York, the judgment of dismissal was reversed (286 N. Y. 468) upon the ground that the "plaintiff is trustee under Section 77B of the Bank-

ruptcy Act (48 Stat. 912) of causes of action alleged to exist in favor of the debtor and referred to in the order of his appointment."

Petitioner had argued that he had capacity to sue as owner or assignee of causes of action of Standard Gas and Electric. In his brief to the Court of Appeals on that occasion, petitioner stated:

> "He is a special trustee in the sense that he does not have title to all of the company's property but only as to some, to wit, the causes of action."

After the decision of the Court of Appeals sustaining the capacity of petitioner to bring the action, Haystone Securities Corporation moved to dismiss the sixteenth cause of action, the only one against Haystone Securities Corporation, on the ground that as to it the complaint was barred by the Statute of Limitations. Under the previous decisions of the New York courts interpreting the Statute of Limitations as it applied to derivative corporate causes of action of this character there could be little doubt as to the favorable outcome of respondent's motion. *Potter* v. *Walker*, 276 N. Y. 15; *Dunlop's Sons, Inc.* v. *Spurr*, 285 N. Y. 333; *Frank* v. *Carlisle*, 286 N. Y. 586. An action on behalf of the corporation was barred in March, 1932 over five years prior to plaintiff's appointment as "special trustee" and more than seven years prior to the commencement of this action. In this predicament petitioner for the first time advanced the proposition that the action was one under Section 60 of the General Corporation Law, and that the petitioner as a bankruptcy trustee brought the action pursuant to Section 70e of the Bankruptcy Act as an independent action in the right of a judgment creditor holding a cause of action duly returned unsatisfied.

It was not apparent from the complaint that the action was in fact brought under Section 60 of the General Corporation Law of the State of New York as alleged in the petition to this Court.

The complaint contained no reference to Section 60. Haystone Securities Corporation was a defendant only to the sixteenth cause of action of the complaint. Haystone Securities Corporation was not a director or officer of Standard Gas and Electric nor was it a transferee of any property of the corporation. No relief against it as transferee was demanded in the complaint. The action was, as indicated by Chief Judge Lehman in his description of it in his opinion, an action to recover moneys and property of the debtor corporation which it is alleged in the complaint the defendants wasted, disposed of or took unlawfully or fraudulently, and to recover profits which it was alleged the defendants wrongfully appropriated. It was in effect an action against fiduciaries or those who, allegedly in connection with fiduciaries, had wrongfully benefited through breach of alleged fiudiciary duty.

Although this action had none of the *indicia* of a creditor's action, and appeared to be one to recover damages because of alleged waste or mismanagement of a corporation by alleged fiduciaries rather than an action to set aside illegal transfers in fraud of creditors, petitioner maintained in the State courts for the purpose of avoiding the Statute of Limitations that this action had become a new and distinct creditor's action as opposed to his previous contention when faced with the challenge to his capacity to sue, that the action was the action of the corporation of which he was the assignee.

The reason for belatedly ascribing the action to Section 60 of the General Corporation Law and claiming for it the status of a creditor's action was that in *Buttles* v. *Smith*, 281 N. Y. 226, the Court of Appeals had held that a judgment creditor's action, solely in the right of the creditor, to set aside a fraudulent transfer of assets of a corporation, was not barred against the creditor until return of execution unsatisfied on a judgment recovered by the creditor for his debt against the corporation. *Buttles* v. *Smith* was a case in which a receiver in sequestration proceedings on behalf of a judgment creditor, holding an execution returned unsatisfied, sued to recover from transferees payments made from an insolvent corporation's funds to pay the personal debts of its president. It was a genuine creditor's action to set aside transfers and not an action on behalf of the corporation. Any action on behalf of the insolvent corporation to recover the funds would have been barred but the Court of Appeals in that case held that as the receiver sued in the right of the creditor but not in the right of or derivatively to the corporation, the cause of action of the judgment creditor did not accrue until the return of execution unsatisfied.

The Court of Appeals, in *Buttles* v. *Smith*, had expressly distinguished a judgment creditor's action from a derivative action on behalf of a corporation. It had stated in describing the nature of the action in *Buttles* v. *Smith*:

> "It is not an action at law for damages sustained in consequence of wilful or negligent acts either of those entrusted with the funds in behalf of the corporation or of defendants. The distinction between the two types of action is clear. (*People* v. *Equitable Life Assur. Society*, 124 App. Div. 714; *Asphalt Con-*

struction Co. v. *Bouker,* 150 App. Div. 691, aff'd 210 N. Y. 643.)"

The Court of Appeals had thus expressly negatived the statement now made to this Court in the petition herein that under its prior decision a judgment creditor would be accorded a superior position when suing to maintain an action for wrongs done to the corporation, or that a different and more beneficial statute would have been applied if a judgment creditor with execution returned unsatisfied had instituted an action on behalf of the corporation for a wrong allegedly done to it.

Assuming that the instant action was an action pursuant to Section 60 of the General Corporation Law, it was obviously not an action to set aside an illegal transfer under subdivision (5) of Section 60. Assuming further that an action under Section 60 could be brought by a judgment creditor for wrongs done to the corporation under subdivisions (1) and (2), and, assuming that the right of such a judgment creditor to bring such an action must be postponed until he had obtained judgment and had an execution returned unsatisfied, a trustee or a special trustee in bankruptcy was under no such disability.

An action under Section 60 may be brought by the corporation or a creditor, receiver or trustee in bankruptcy thereof, or by a director or officer of the corporation. While there might have been an impediment therefore to an action by a judgment creditor until he had obtained judgment and had execution returned unsatisfied, there was no impediment to such an action by the corporation or by its assignee or by a trustee in bankruptcy suing in the right of the corporation. It was argued by Haystone Securities Cor-

poration to the Court of Appeals that this action could not be brought upon any independent creditor's right and that no independent creditor's cause of action would pass to a bankruptcy trustee.

It was suggested that the decisions of the State and Federal courts are unanimous that a cause of action accruing solely to the creditors of a corporation and not belonging to the corporation itself does not pass to the trustee in bankruptcy. (*Courtney* v. *Georger*, 228 F. 859, certiorari denied 241 U. S. 660; *Morris* v. *Sampsel*, 224 Wisc. 560, certiorari denied 305 U. S. 608; *In re Jacoby*, 138 F. (2d) 42; *Sanford* v. *Boland*, 287 N. Y. 431; Collier on Bankruptcy [14th ed.], §70; Remington on Bankruptcy [4th ed.], §1197.)

The Court of Appeals recognized the force of this argument but found it unnecessary to pass upon it in view of its holding "that under the law of the State the cause of action here asserted is based upon a wrong to the corporate debtor and accrued when the wrong to the debtor corporation was complete" (R. 86).

As to whether or not the action was brought under Section 60, the Court said (R. 86):

> "We assume *arguendo* that the action against Haystone Securities Corporation and its co-defendants is brought in behalf of creditors for the relief specified in subdivisions (1) and (2) of Section 60, though there may be little in the complaint to support that assumption."

The Court, therefore, gave the petitioner the full benefit of his contention in reaching its decision.

The Writ Should Be Denied

Petitioner's concession (p. 8, petition) that the Court of Appeals did not question that petitioner occupied the status of a trustee in bankruptcy, with the right of a judgment creditor pursuant to Section 70(c) of the Bankruptcy Act should dispose of the petition. A determination as to the nature and extent of the right of a judgment creditor obviously involves no federal question. In urging his reasons for granting the writ, petitioner mistakes the holding of the Court of Appeals in the instant case. The Court of Appeals did not decide that a different and more beneficial statute would have applied if a judgment creditor with execution returned unsatisfied had instituted the action, nor are there any prior decisions to this effect which he can cite.

Even if the decision of the Court of Appeals in this case were inconsistent with prior decisions, the question decided would still remain a question for the State court and not a federal question.

As Mr. Justice Holmes stated in *Patterson* v. *Colorado*, 205 U. S. 454:

> "* * * There is no constitutional right to have all general propositions of law once adopted remain unchanged. Even if it be true, as the plaintiff in error says, that the Supreme Court of Colorado departed from earlier and well-established precedents to meet the exigencies of this case, whatever might be thought of the justice or wisdom of such a step, the Constitution of the United States is not infringed."

The proposition propounded by petitioner finds no support in any state statutes or the decisions of any state or federal court. The proposition was, in substance, that where a bankruptcy trustee brings a plenary suit in the New York courts on a cause of action of the bankrupt or debtor, no matter how stale or how long outlawed in the hands of the debtor, the cause of action would be revived because, being brought by a bankruptcy trustee it would become *ipso facto* a new and independent cause of action on the same facts in the nature of a creditor's action. None of the cases cited by petitioner under the "strong-arm clause" of the 1910 amendment to the Bankruptcy Act gives any weight to such a proposition.

In re Dalton Electric Company, 7 F. Supp. 465, 468 (D. C. Miss.) cited by petitioner is merely an instance of the application of State law to the determination of the rights of creditors in the State of Mississippi. In that case, the question decided was as to the power of a creditor to sue under Section 4151 of the Mississippi Code of 1930.

If, as he contends, petitioner asserts a creditors's cause of action created by New York statute, he cannot escape the conclusion that the interpretation of the New York statute and the determination of his rights under the statute is solely for the New York courts. While the Court of Appeals in its opinion stated that there may be little in the complaint to support the assumption that the action was brought under the New York statute, it disposed of the case as if the action were an action under Section 60 of the General Corporation Law. In *De Saussure* v. *Gaillard,* 127 U. S. 216, in holding that the Supreme Court of South Carolina was not subject to review in its construction of a State statute, the Court said:

> "It is a state statute conferring certain rights upon suitors choosing to avail themselves of its provisions under certain conditions in certain cases. Who may sue under it, and when, and under what circumstances, are questions for the exclusive determination of the state tribunals, whose judgment thereon is not subject to review by this court." (p. 233)

It is for the State court to construe and apply the Statutes of Limitations enacted by the State Legislature, and its decisions in this respect are not subject to review. (*Harrison* v. *Myer,* 92 U. S. 111; *Wood* v. *Chesborough,* 228 U. S. 672.) Where it appeared that the Supreme Court of Tennessee could have decided a case by sustaining defense of the Statute of Limitations, there was no Federal question necessarily involved. (*Johnson* v. *Risk,* 137 U. S. 300.)

In an action by an assignee in bankruptcy to set aside conveyances as being in fraud of creditors, the validity of the conveyances is not a Federal question. (*McKenna* v. *Simpson,* 129 U. S. 506.)

While it is true that New York courts have several times held that a creditor has no status to bring an action under Section 60 of the General Corporation Law unless he has first obtained a judgment with execution returned unsatisfied, there has never been any holding as to the applicable Statute of Limitations upon a suit by a creditor with such a status when seeking to realize upon choses of action of an insolvent corporation. When the Court of Appeals in this case finally decided this question, it based its decision on substantial State grounds.

> "This Court from the time of its foundation has adhered to the principle that it will not review judgments of state courts that rest on adequate and independent state grounds. *Murdock* v. *Memphis,* 20 Wall. 590, 636; *Berea College* v. *Kentucky,* 211 U. S. 45, 53; *Enterprise Irrigation District* v. *Farmers Mutual Canal Co.,* 243 U. S. 157, 164; *Fox Film Corp.* v. *Muller,* 296 U. S. 207. The reason is so obvious that it has rarely been thought to warrant statement. It is found in the partitioning of power between the state and federal judicial systems and in the limitations of our own jurisdiction." (*Herb* v. *Pitcairn,* U. S. (Nos. 24 & 25 this term decided Feb. 5, 1945).)

There is nothing in this record which is ambiguous or which presents any reasonable grounds to believe that the judgment rests on the decision of a Federal question.

CONCLUSION

The record discloses that no Federal question was presented for decision to the New York Court of Appeals. The decision of the Court of Appeals was concerned solely with the interpretation and application of State statutes. The petition for certiorari should be denied.

Respectfully submitted,

HORACE G. HITCHCOCK,
Counsel for Respondent.

DWIGHT R. COLLIN,
of Counsel.